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China Employment Law Update - February 2014

Abstract

An update in ongoing developments regarding labor relations and employment in China.

Keywords

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Comments

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China Employment Law Update

People's Republic of China

BAKER & MCKENZIE

February 2014

Labor Dispatch Capped at 10% of Workforce

On January 24, the Ministry of Human Resources and Social Security issued the *Provisional Regulations on Labor Dispatch* ("Labor Dispatch Regulations"), which will take effect on March 1, 2014. Three days later, it issued a circular providing guidance to lower-level labor authorities on implementation of the new regulations. The Labor Dispatch Regulations clarify some important issues on the use of dispatched workers, but also leave some issues of concern still unclarified. (The term "dispatched workers" is similar to temp workers, agency workers or contingency workers as used in other countries.)

- **Dispatched Workers Capped at 10% of Total Workforce**

The Labor Dispatch Regulations specify that dispatched workers may not make up more than 10% of an employing unit's workforce. When calculating this ratio, the number of dispatched workers should be divided by the total number of directly employed employees and dispatched workers at the employing unit.

Companies that use dispatched workers exceeding this maximum ratio are allowed a two-year grace period expiring February 28, 2016, but they must file a report on how they plan to reduce their use of dispatched workers with the local labor authorities. Before reducing its use of dispatched workers to the 10% ratio or below, a host company is not allowed to hire any new dispatched worker. If a dispatched worker's employment contract (signed with a staffing agency) and the labor dispatch agreement between the staffing agency and the host company was signed prior to December 28, 2012 (the promulgation date of the new Employment Contract Law or "ECL"), such contracts/agreements may continue to be performed in accordance with their terms until expiration, even beyond February 28, 2016.

- **Employee Consultation Required to Determine "Auxiliary Positions"**

Labor dispatch is only permitted to be used in positions that are temporary, auxiliary or substitute in nature. An "auxiliary position" is defined in the ECL as a non-core position that provides services to the company's main business. However, the ECL was not clear about how to determine what constitutes a company's main business and non-core business.

The Labor Dispatch Regulations now stipulate that a company can determine which positions are auxiliary through employee

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consultation procedures in accordance with Article 4 of the ECL. Art.4 procedures require consultations with all employees or an employee representative council as well as the union (if there is one), but the company does not need to reach an agreement with employees. This effectively means that management within reason has discretion in determining for which positions dispatched workers may be hired, subject to complying with certain consultation formalities and the overall 10% cap. If a company fails to go through the consultation procedures, the labor authorities may order rectification and give a warning, and if there are any damages caused to any dispatched worker, the company is also required to pay compensation.

- **Additional Grounds for Return of Dispatched Worker**

In addition to the situations specified in the ECL where a host company may return a dispatched worker to the staffing agency, the Labor Dispatch Regulations clarify that a host company may also return a dispatched worker to the staffing agency when: (i) the host company undergoes a major change of objective circumstances or conducts a mass layoff, (ii) the host company goes bankrupt, dissolves, has its business license revoked, or is ordered to shut down, etc., or (iii) the labor dispatch agreement between the staffing agency and the host company expires. During the time when the returned worker does not have work to do, the staffing agency only needs to pay the returned worker the local minimum wage.

However, the host company is not allowed to unilaterally return a dispatched worker who is protected from unilateral termination by law (e.g., the employee is still in the statutory medical treatment period, or is pregnant or in her nursing period, etc.).

- **Equal Pay for Equal Work**

The Labor Dispatch Regulations simply state that there should be no discrimination against dispatched workers in relation to any benefits related to a job position, but do not provide further guidance as to the exact scope of this requirement or how it should be interpreted / implemented.

- **Applicability of Open-Term Contract Entitlement to Dispatched Workers Still Unclear**

The Labor Dispatch Regulations remain silent on the issue whether the open-term contract rules also apply to dispatched workers. Normal employees are entitled to an open-term contract after completing two fixed-term contracts with the same employer or after serving 10 years with the same employer. It is not clear whether a dispatched worker in these situations would be entitled to an open-term employment contract with the agency, as well as

an open-term dispatch term with the host company. Open-term contracts provide job security potentially up to retirement.

This issue is now left to the courts to decide, which may lead to different interpretations locally.

- Employee Right to Claim *De Facto* Employment Still Unclear

A provision in the original draft regulations stated that dispatched workers hired outside the allowable scope could claim for *de facto* employment with the host entity, but this provision has been left out of the final Labor Dispatch Regulations. Dispatched workers now have no clear legal basis to raise such a claim. However, they can submit complaints to the local labor bureau, which can order rectification and then impose a fine if the violation is not rectified within the deadline specified by the labor bureau.

Employees may still try to make *de facto* claims in court, which again may lead to different practices locally.

- No Clear Definition of “Outsourcing”

Given the strict rules on labor dispatch, many companies are changing their hiring methods from labor dispatch to outsourcing. However, there remains no clear definition of “outsourcing” under PRC law (a provision in the draft regulations on this issue was left out of the final version), and this would remain an issue to be determined by the courts based on both employment law and contract/civil law principles.

Recent Developments in Occupational Health Protection

The *Regulations on Administration of Occupational Health Records* (“**Health Records Regulations**”) of December 31, 2013 increase employer obligations in terms of maintaining and retaining occupational health records. Employers must maintain: individual employee records on health monitoring and health protection measures, educational and training records related to occupational health information, inspection and surveillance records on workplace health hazards and prevention measures compiled by qualified third-party inspectors, etc. Employers must provide these records to employees upon termination, as well as to government authorities and diagnostic institutes, upon request.

While the Health Records Regulations themselves do not contain any penalty provisions for non-compliance, penalty provisions in the *Law on the Prevention of Occupational Diseases* and other implementing regulations would likely apply.

In a related development, the *Occupational Disease Classification and Catalogue* (“**Catalogue**”) was expanded by 18 new occupational

diseases, bringing the total number of occupational diseases to 132. New occupational diseases include AIDS (limited to medical/health professionals and police), explosive deafness, and frostbite.

Shenzhen Establishes Equal Opportunities Commission

In January, the Shenzhen municipal government announced its plan to establish a “sex equality promotion organization” to facilitate the implementation of the Shenzhen Regulations on the Promotion of Sex Equality (i.e., the first local regulations to exclusively address the issue of gender equality). The organization shall promote the establishment of rules with respect to gender statistics, gender analysis in public policies, anti-harassment, etc. It appears that the new Shenzhen organization will attempt to function in a similar way to equal opportunity bodies in the US and other jurisdictions, although its authority and roles are not clear yet.

Recent Discrimination Cases

On January 6, 2014, the Guangzhou Municipal Yuexiu District People’s Court accepted the first household permit (*hukou*) discrimination case ever heard in Guangdong province. In this case, the employer specified in its online recruitment advertisement that the position was open to persons with Guangzhou household permits only. One candidate with a non-local *hukou* was rejected. He then claimed that he was discriminated against based on his household permit status. After his lawyer reportedly visited the court five times, the judges finally agreed to accept the case. The final ruling is still pending.

In another case, the Beijing Municipal Chaoyang District People’s Court refused to hear a claim alleging discrimination on the basis of sexual orientation. The company’s CEO had made an offer of employment in a TV show, but the company later refused to sign a contract, allegedly because it found out that the candidate was gay. The court refused to accept the case on technical grounds, reasoning that this was an employment case and thus should be filed with the local employment dispute arbitration commission first. The candidate’s lawyer argued that the candidate did not form any employment relationship with the company, and thus, this should be a civil case over which the court should have jurisdiction. However, rather than challenging the court’s decision, the candidate was reportedly preparing to submit his claim of discrimination to the local employment dispute arbitration commission.

Under PRC law, discrimination against an employee or job applicant on the basis of race, ethnicity, sex, religion, pregnancy, marital status, disability, communicable disease carrier status, and migrant worker status (i.e., workers who hold rural household permits but work in

urban areas), is prohibited. In practice, however, the majority of anti-discrimination laws are not well understood or rigorously enforced by the courts or relevant government agencies. In many circumstances, the courts refuse to accept discrimination cases, presumably to avoid any substantive analysis on sensitive discrimination issues. The above cases show the general reluctance of courts to actively wade into this area.

First Ever Pre-Litigation Preliminary Injunction Order Issued in Trade Secret Case

In early January, the Shanghai No. 1 Intermediate People's Court issued China's first ever *pre-litigation* preliminary injunction in a dispute between a Chinese subsidiary of a large multinational pharmaceutical company and its ex-manager. This is the same court that issued China's first ever preliminary injunction in a trade secrets case in July 2013, though in that case the preliminary injunction was applied for after the plaintiff had formally brought a civil claim against the ex-employee.

In this case, the ex-employee downloaded 879 documents containing trade secrets from the company's database after he submitted a resignation letter to the company. He later joined a competitor of the company. The company then filed for a (pre-litigation) preliminary injunction against the ex-employee before the Shanghai No. 1 Intermediate People's Court, seeking to restrain the ex-employee from disclosing, using, or allowing others to use the documents containing trade secrets and related confidential information. The court accepted the petition on the same day and issued a preliminary injunction order within 48 hours thereafter.

The chief judge in this case later commented that the court made the ruling based on five main factors: whether or not the claim was totally frivolous, the potential threat of irreparable damage or injury to the petitioner, a balancing of potential costs/harms of each party, the urgency of the petition, and the public interest. The chief judge, however, did not mention whether the likelihood of success on the merits of the underlying trade secrets case was relevant to the decision.

Under the Amended PRC Civil Procedure Law, the court is required to rule, within 48 hours, on any pre-litigation preliminary injunction petition. By contrast, if a preliminary injunction petition is made during an ongoing litigation, the courts are only required to act where the circumstances are urgent.

This case again shows the willingness of Shanghai courts to grant preliminary injunctive remedies in trade secret cases. As courts become more experienced in handling similar cases, it can be hoped that they will also issue preliminary injunctive orders in other types of civil cases, possibly including breach of non-compete cases. However, courts in other cities, such as Beijing, have yet to follow Shanghai's lead.

Termination Unlawful Because Employer Applied Valid Company Policy in Bad Faith

In a recent case reported on January 14, 2014, the Intermediate People's Court of Suzhou Municipality, Jiangsu Province upheld an employee's claim for RMB 85,000 against his former employer for unlawful termination, because the employer relied in bad faith on a valid company policy.

The company's policy required employees to file for and receive advance approval to take leave and provided that taking leave without approval was considered absenteeism. On January 30, 2013, (about 10 days before the beginning of the Chinese New Year holiday), the employee submitted an application to take leave a few days before and after Chinese New Year, so that he could travel to his hometown in Hubei to celebrate the Chinese New Year. After the employee submitted the leave application, the company talked to him several times and tried to persuade him to stay in Suzhou during the Chinese New Year holiday. However, in none of the talks did the company say whether it was approving or rejecting the employee's leave application. The employee still left Suzhou for Hubei. Two days later (after the beginning of the Chinese New Year holiday), the company officially rejected the employee's leave application on the company's internal network, and the employee was later terminated for absenteeism in accordance with the company's written policy on absenteeism.

The employee's claim for unlawful termination was rejected in arbitration and the court of first instance. However, the appellate court ruled the termination unlawful by citing a violation of the principle of good faith. The principle of good faith requires an employer to provide express approval or rejection of an employee's leave application within a reasonable period of time. According to the appellate court, asking the employee to stay in Suzhou during the Chinese New Year holiday did not constitute an express rejection of the leave application. Instead, the express rejection was only provided after the employee had already taken leave, which the court concluded was not within a reasonable period of time because it came after the start of the Chinese New Year holiday.

This case shows that a court may use the civil-law principle of good faith to challenge the unilateral termination of an employee even when such termination is in accordance with valid company policies.

Employer Ordered to Pay Year-End Bonus to Ex-Employee

In a case reportedly decided by a Beijing court in January 2014, the employer was ordered to pay the year-end bonus to an ex-employee.

The parties had entered into a year-end bonus agreement, which provided for the target amount of the bonus and payment time. The ex-employee

separated from the employer without being paid the year-end bonus, and then brought a claim for the bonus. The employer argued that the year-end bonus was not a guaranteed payment, but rather dependent on the company's business performance, and that its business performance was poor. Therefore it decided to not pay any bonus to the employee. The court was not convinced by this argument and ordered the employer to pay the year-end bonus to the ex-employee.

The judge pointed out that a bonus is a part of the employee's expected compensation. He therefore reasoned that it would be unfair for a company to unilaterally decide whether or not to pay such bonus, even in the case of "discretionary" bonuses.

Deceased Worker of Sub-contractor Held to Have De Facto Employment with Construction Company

In December 2013, the People's Court of Linmu County, Shandong Province, reportedly ruled that a *de facto* employment relationship existed between a construction company and a worker of a subcontractor who died on the construction company's project site.

In 2012, a construction company, as the general contractor, undertook a project to build residential housing. The construction company subcontracted the moulding and carpentry work to an individual, who in turn subcontracted the work to three other individuals. One of the individuals further sub-contracted some work to Mr. Wang (not his real name). In October 2012, Mr. Wang died on the project site. The construction company paid RMB 100,000 in funeral expenses to the family of Mr. Wang. In December 2012, the Wang family filed for arbitration claiming a *de facto* employment relationship existed between Mr. Wang and the construction company (the report did not go into detail on the exact remedies claimed, though the family assumedly demanded work injury benefits from the construction company). In March 2013, the labour arbitration committee ruled in favour of the family. The construction company challenged the arbitration award in the local people's court and argued that since Mr. Wang was recruited, managed and paid by the sub-subcontractor, no employment relationship existed between Mr. Wang and the construction company.

The local people's court affirmed the arbitration award and ruled that a *de facto* employment relationship did exist between Mr. Wang and the construction company because the construction company subcontracted construction work to individuals who were not licensed contractors. Neither the subcontractor nor the sub-subcontractors had the legal capacity to hire employees. According to a notice issued by the Ministry of Human Resources and Social Security in 2005, if an entity, such

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as a construction or mining entity, contracts work to an unlicensed organization or individual who does not have the legal capacity to hire employees, then the construction or mining entity assumes employer responsibilities for any worker recruited by such organization or individual to complete the work.

Companies, especially construction and mining enterprises, should be selective when subcontracting work to a third party. Otherwise, the company could inadvertently establish *de facto* employment relationships with workers recruited by a subcontractor that do not have the legal capacity to hire employees.

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